

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

RECEIVED

DOCKET FILE COPY ORIGINAL

MAY - 4 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the matter of

Fees for Ancillary or Supplementary
Use of Digital Television Spectrum
Pursuant to Section 336(e)(1)
of the Telecommunications Act of 1996

MM Docket No. 97-247

**COMMENTS OF
THE ASSOCIATION OF LOCAL TELEVISION STATIONS, INC.**

Association of Local Television Stations, Inc.
1320 19th Street, N.W.
Suite 300
Washington, D.C. 20036
(202) 887-1970

May 4, 1998

No. of Copies rec'd
List ABCDE

011

I.	INTRODUCTION AND SUMMARY	2
II.	REGARDLESS OF THE TYPE OF FEE ADOPTED, THE AMOUNT OF THE FEE SHOULD REMAIN VERY MODEST.	4
A.	Fees Should Recover No More Than a Portion of Anticipated Spectrum Scarcity Rents.	5
B.	Spectrum Scarcity Rents Are Likely to Be Very Modest.	9
C.	The Social Cost of Excessive Fees Greatly Exceeds the Cost of Overly Modest Fees.	11
III.	A FEE SET AS A PERCENTAGE OF GROSS RECEIPTS GENERALLY WOULD BE PREFERABLE.	15
IV.	A FEE EQUIVALENT TO NO MORE THAN ONE PER CENT OF GROSS REVENUES WOULD BE REASONABLE	17
V.	FEEES SHOULD BE WAIVED ENTIRELY FOR UNPROFITABLE SERVICES.	19
VI.	CONCLUSION	21

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.**

In the matter of

Fees for Ancillary or Supplementary
Use of Digital Television Spectrum
Pursuant to Section 336(e)(1)
of the Telecommunications Act of 1996

MM Docket No. 97-247

**COMMENTS OF
THE ASSOCIATION OF LOCAL TELEVISION STATIONS, INC.**

The following comments are submitted by the Association of Local Television Stations, Inc. ("ALTV"), in response to the Commission's *Notice of Proposed Rule Making* in the above-captioned proceeding.¹ ALTV is a non-profit, incorporated association of broadcast television stations unaffiliated with the ABC, CBS, or NBC television networks.² ALTV's member stations will be affected directly by the Commission's action in this proceeding.

¹FCC 97-414 (released December 19, 1997)[hereinafter cited as *Notice*].

²Local stations among ALTV's members include not only traditional independent stations, but also local television stations affiliated with the three emerging networks, Fox, UPN, and WB, and the nascent PaxNet network. As used herein, the term "local television stations" includes ALTV member stations, but excludes affiliates of ABC, CBS, and NBC.

ALTV concurs with the Commission that a fee based on a modest percentage of gross revenues provides the most practical fee structure consistent with the statute. Additionally, the Commission should waive fees entirely for unprofitable services. The Commission also should cap fees so as to avoid recovering fees in excess of the spectrum scarcity values the fees are designed to extract from DTV licensees under the statute.

The Commission faces a daunting task.³ It is navigating a treasure ship on an uncharted sea with limited visibility and no radar, LORAN, or GPS. Few digital stations are on the air. Ancillary and supplementary services remain gleams in the eyes of engineers and entrepreneurs. Even those stations with well-defined plans for such services hardly are anxious to share proprietary business plans with the world. Therefore, although the statutory criteria are clear, they must be applied in a factual vacuum. Thus, it is one thing to recover a portion of the value of the spectrum used for supplementary and ancillary digital services, but quite another to place a value on that spectrum in the first place. Avoiding unjust enrichment is a worthy goal, but unjust *vis-a-vis* what. Remaining within the bounds of amounts which would have been recovered at auctions makes perfect sense, but, again, how does one estimate the amount which might have been recovered in an auction. The Commission is left to take its bearings on the few salient features in the seascape and set its course accordingly. All the while, treasure hunters (*nee* pirates) lurk perilously close, watching its every move, guns trained, ready at the moment to cut loose a remonstrative salvo at the slightest deviation from a "reasonable" course. Daunting, yes. Dangerous, yes. Impossible, no.

³As Commissioner Ness has stated, "I have felt for some time now that, of all the decisions that I would be called upon to make as an FCC Commissioner, the ones that would most affect the day-to-day lives of every American would be those relating to digital television (DTV)." Remarks of Commissioner Susan Ness, DTV Supersession, Las Vegas, Nevada (January 9, 1998) at 1.

The Commission may steer its course clear of the shoals of caprice by keeping its eye on several prominent considerations. First, a fee generally based on gross revenues is highly desirable as a practical matter. Second, the existence of a relationship between gross revenues (output) to the value spectrum dedicated to ancillary and supplementary DTV services (input), is theoretically sound. Third, the relationship of current spectrum auction revenues to the scarcity value of spectrum used for ancillary and supplementary DTV is equally unassailable. Finally, as the Commission has emphasized, fees which discourage development of ancillary and supplementary DTV services would be counterproductive. None of these considerations is without blemish, but they are the most luminous constellations piercing an otherwise hazy horizon.

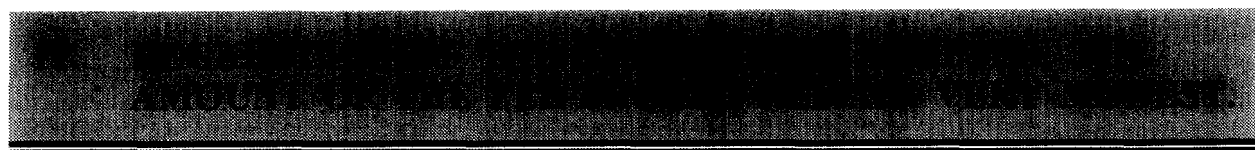
In ALTV's view, these considerations compel adoption of a low fee based on gross revenues. Essentially, the statute contemplates recovery of spectrum scarcity rents from stations using a portion of their DTV spectrum for ancillary and supplementary services. The sharp decline in spectrum auction revenues (despite differences in the spectrum at issue) hardly may be ignored in predicting or "guesstimating" what those scarcity rents might be; indeed, they are the only real values which exist. They provide substantial evidence that spectrum scarcity rents for ancillary DTV services are likely to fall between very modest and nil. Furthermore, whereas the conceptual relationship between input (spectrum value) and output (revenues) is sound, the basic data necessary to move from theory to practice does not exist today. Nonetheless, the soundness of the theory, along with the practical benefits of a fee based on gross receipts, lends some support to the Commission's apparent preference for such a fee.

Additional support for the notion of a fee at the low end of the range (*i.e.*, one-half to one percent) is derived from weighing the relative risks of too high a fee versus too low a fee. If fees are too high, they will create a disincentive to provide new services, leading to losses in consumer welfare. If feeable services are not provided, then fee revenues also will be diminished, frustrating even the government's very modest expectations in that regard. On the other hand, if fees are too

low, the social costs are smaller. The primary effect would be a wealth transfer with little effect on consumer welfare.

ALTV does urge two variations from a straight gross revenue based fee. First, the Commission should waive fees entirely where stations are willing to make showing that a particular service is unprofitable. Such waivers would recognize that no scarcity rents exist. They also would afford stations breathing room to develop services to the break-even point before paying fees. Second, fees of any type should be capped, lest they exceed spectrum scarcity rents in violation of the statute.

In support whereof, the following is shown:



Both the statutory criteria and the need to avoid consumer welfare losses dictate imposition of very modest fees. As the Commission states:

The percentage rate of the fee must reflect the statutory requirements that the fee recover a portion of the value of the spectrum used for these services, avoid unjust enrichment, and approximate the revenue that would have been achieved had these services been licensed through an auction.⁴

The Commission also notes its "goal of permitting broadcasters flexibility to provide feeable ancillary or supplementary services" and states its reluctance "to set the percentage rate so high that it would dissuade broadcasters from providing feeable ancillary or supplementary services."⁵

⁴Notice at ¶27.

⁵Notice at ¶27.

A. Fees Should Recover No More Than a Portion of Anticipated Spectrum Scarcity Rents.

ALTV submits that setting fees at a level which will capture a reasonable portion of spectrum scarcity rents with respect to spectrum devoted to ancillary and supplementary DTV services readily conforms to the statutory criteria. As stated by John Haring in his analysis of the issue for ALTV:

[T]he Commission should be after (and what the statute is after) is a reasonably effective means for capturing a portion of the spectrum scarcity rents (to the extent any exist) associated with provision of ancillary and supplementary services. These rents place an upper-bound on the amount the Commission's fees should attempt to recover.⁶

This analysis embraces the statutory provision specifying that the amount of fees collected

[T]o the extent feasible, equals but does not exceed (over the term of the license) the amount that would have been recovered had such services been licensed pursuant to the provisions of section 309(j) of this Act and the Commissions's regulations thereunder...⁷

Haring points out that

[A]n auction of spectrum resource rights provides a means of measuring and extracting anticipated scarcity rents. Thus, Congress' instruction to structure fees, to the extent feasible, to capture what would have been recovered in an auction, and no more, is closely equivalent to an instruction to structure fees to recover scarcity rents.⁸

Recovery of scarcity rents also necessarily would "recover for the public a portion of the value of the public spectrum" used by stations to provide ancillary and supplementary DTV

⁶Haring, John, *Fees for Ancillary and Supplementary Use of Digital Television Spectrum*, Strategic Policy Research (April 28, 1998), at 2, a copy of which is attached hereto [hereinafter cited as "Haring"].

⁷47 U.S.C. §336(e)(2)(B).

⁸Haring at 5. *See also* Haring at 3 ("[T]he amount that would have been realized at a real or hypothetical auction of relevant resource rights in principle measures the discounted present value of anticipated spectrum scarcity rents.").

services.⁹ Finally, looking to spectrum scarcity rents comports with the notion of avoiding unjust enrichment. As Haring observes, "Licensees might be unfairly advantaged if spectrum scarcity rents turn out to be greater than zero ... and they have not had to pay for usage rights while others have."¹⁰ With fees designed to recover spectrum scarcity rents, DTV licensees would benefit from no "arbitrarily favorable treatment."¹¹ Therefore, as Haring concludes, "Establishing a regime that is designed to recover a portion of the relevant scarcity rents supplies a means for reconciling the Act's various requirements in an economically coherent way."

Whereas the Commission is "disinclined to base the fees on a model that would seek to simulate the revenue that would be generated from an auction," it must take some cognizance of declining spectrum values. First, the statute expressly requires it. Second, the impossibility of assessing today a "fee directly tied to an auction model estimate" of spectrum value provides no

⁹47 U.S.C. 336 (e)(2)(A)(i). As the Commission acknowledges:

The 1996 Act first directs that any fee we establish should "recover for the public a portion of the value of the public spectrum" made available for ancillary or supplementary use by DTV licensees. This requirement echoes the competitive bidding provisions of the Communications Act of 1934 ("Communications Act").

Notice at ¶7.

¹⁰Haring at 5, n.6.

¹¹Haring at 5. However, as Haring further notes:

This is not quite the same thing as saying, as the Commission does (at ¶ 7), that licensees could be unfairly advantaged if they did not have to pay a fee while competitors have acquired their operating rights at auction. Licensees might be unfairly advantaged if spectrum scarcity rents turn out to be greater than zero in the event and they have not had to pay for usage rights while others have. The amount a competitor may have paid in an earlier auction does not necessarily correspond to the scarcity rents realized in the event. A competitor who has paid more for rights than they turn out to be worth may be disadvantaged, but this may be the result of his overpaying rather than a later competitor's underpaying.

Haring at 5, n.6.

valid reason to ignore spectrum values indicated by prior auctions of other spectrum. As Haring says:

It is important to recognize, as the Commission does, that the amount that would have been recovered in an auction depends on the specific content of the resource rights being auctioned.

Previous auctions have often dealt with substantially different spectrum resource rights than those currently at issue. The fact that a Rembrandt drawing fetched a certain amount at auction may provide scant basis for predicting the auction value of a Cezanne oil — scant basis, but not no basis. Any valuation exercise of this type inevitably entails a process of guesstimation.¹²

Haring further observes:

Some method for scaling fees to activity levels is plainly required, and we would certainly not deny (indeed, we would emphasize) the need for careful analysis and interpretation of the historical record pertaining to spectrum sales and auctions in making any extrapolations of value. Nevertheless, the historical information and trends at least supply some actual data points from which perhaps to begin to draw inferences about plausible valuations.¹³

Third, other possible methods of assessing spectrum scarcity rents appear less than fully adequate standing alone. For example, the Commission's input/output methodology appears based on the concept that "a fee could be assessed as a function of revenues or profits and still be conceptually

¹²Haring at 8. In this regard, he notes:

The Congressional Budget Office (CBO) has, for example, actually "guesstimated" the amount that would have been received in an auction of "the [DTV] spectrum." But this guesstimate addresses a somewhat different set of (less constrained) resource rights than is now at issue. Thus, if one were "guesstimating" the amount that would be recovered in an auction of the ancillary and supplementary resource rights now under consideration, one would need to put the scarcity value at a lower level to reflect the conditions on acceptable usage the government has imposed.

Haring at 8.

¹³Haring at 8-9.

related to spectrum scarcity values.”¹⁴ However, one remains essentially stalled.¹⁵ If the Commission truly contemplated “the empirical identification of input/output relationships between spectrum resources and outputs of various ancillary and supplementary services, it would “constitute a formidable analytical undertaking involving a substantial resource expenditure.”¹⁶ Moreover, even if the basic data necessary to conduct the analysis existed -- which it does not today -- the results would remain little more than an approximation.¹⁷ As Haring notes:

[A]ctual implementation of the approach, which is seemingly not immediately contemplated or actually practicable given the information and work requirements, at best promises only “an approximation of an implicit value over a range” and, even then, only after some heavy empirical lifting.

Id. Furthermore, the input/output analysis suffers conceptual shortcomings. As Haring points out:

While relevant scarcity rents may tend to be proportional to revenues or profits from sales of such services, they are not necessarily so and are certainly not synonymous with these measures. Consider that a firm may be able to transform sand into highly valued computing capabilities by combining it with other factors of production, notably human intellect, but that this does not convey a high scarcity value on sand. That sand can be supplied at low cost and that there are substitutes for sand make the scarcity value of sand minimal, notwithstanding the valuable uses to which sand may be put. DTV licensees may eventually be able to utilize their operating rights to supply valued feeable services and may even earn economic profits in so doing. These possibilities do not automatically translate into spectrum scarcity rents anymore than that billions of dollars’ worth of computer sales imply that sand possesses a high scarcity value or that sand supply ought to be more highly remunerated.

¹⁴Haring at 11. Haring notes that , “[T]his seems unexceptionable.” *Id.*

¹⁵Haring at 3 (“However the fee system is *operationalized*, it should be *calibrated* to collect no more (and optimally probably less) than the relevant spectrum scarcity rents, to the extent that there are any. It may make sense to specify fees as a percentage of gross revenues, but that leaves (or presumes a reasonable answer to) the question of what percentage would be appropriate and that, in turn, demands a standard for judging reasonability.”).

¹⁶Haring at 10.

¹⁷Haring at 10.

None of this is to disparage the utility of the Commission's input/output analysis. ALTV only wishes to suggest that like any approach in a world of unknowns, it is imperfect, and, perhaps, unable on its own to bear the entire burden of supporting the Commission's new fee regime.

Indeed, looking only to spectrum auction revenues also is less than perfect, for reasons well-recognized by the Commission and acknowledged by Haring. Nonetheless, as the Commission traverses a barren landscape, it must find its bearings on the basis of any salient features. Among them, spectrum auction values appear quite prominent.

B. Spectrum Scarcity Rents Are Likely to Be Very Modest.

The potential for significant spectrum scarcity rents is diminishing as spectrum values decrease. Spectrum values are decreasing -- and markedly so -- in the wake of recent increases in the supply of spectrum. Commissioner Powell recently recalled the genesis of the long tightly constricted supply of spectrum:

A little known historical fact, certainly never mentioned in the current hit movie, is that the Titanic disaster prompted the United States government to seize control of the airwaves. Which, in turn, set us out on a regulatory journey that led to the concept that the airwaves are public property and, as such, what one does with them and what one says over them can be determined, in part, by the government.

It seems that amateur radio operators up and down the East coast heard the sinking vessel's call for help and filled the airwaves with questions and rumors that interfered with the rescue efforts. As a consequence, the government decided to step in and began regulating the airwaves. The result was that the government (i.e., the military) got the best spectrum and the highest priority when it came to use. Commercial interests took a clear back seat¹⁸

Although interest in the Titanic has swelled, the government's interest in hoarding spectrum has changed. Much to the contrary, the government now is pursuing the dispensation of spectrum via

¹⁸Remarks (as prepared for delivery) by Michael K. Powell, Commissioner, Federal Communications Commission, before The Freedom Forum, Arlington, Virginia (April 27, 1998) at 2.

auction with a vengeance born of decades of budget deficits. Consequently, the supply of spectrum has increased dramatically.

The consequence in turn has been a now dramatic decline in the value of spectrum. As supply has increased, prices have fallen. The starkest illustration of this development is the fear expressed last week that "What if we gave a spectrum auction and nobody came?" That fear precipitated requests from the Commission to delay auction of wireless spectrum (required by August 10, 1998), citing an unprecedented lack of interest.¹⁹ Haring similarly observes:

Scarcity values reflect the interaction of economic forces of supply and demand. Generally speaking, as the FCC has rationalized its management of the spectrum and substantially increased the supply of spectrum resource rights, the scarcity value of the spectrum has progressively fallen. This is illustrated by the secular decline in the auction values of various spectrum resource rights used for mobile communications services, which fell from over \$3 per MHz per pop in 1994 to some 30 cents per MHz per pop in 1997. Indeed, if one were extrapolating based on the trend in auction values, one would predict that scarcity values will soon become virtually nil.²⁰

As last week's events demonstrate, that prediction apparently now has come true.

¹⁹"Kennard Asks to Delay Next Wireless Auction," *Communications Daily* (April 30, 1998) at 1. The article also reports that the Commission received no responses to its request for comments on proposed revisions to its auction rules.

²⁰Haring at 14-15. He also points out that "The FCC's recent auction of licenses for local multipoint distribution services imply very small scarcity values (*viz.*, less than *one-fifth of a cent* per MHz per pop)." Haring goes on to say that

These licenses generally appear to embody resource rights for services similar to, although arguably more expansive and valuable than, the rights to offer ancillary and supplementary services using the DTV spectrum. Even the LMDS values may thus overstate the value of DTV rights to supply ancillary and supplementary services.

²⁰*Id.* He notes that "The DTV spectrum will be used to supply non-feeable services (*viz.*, free TV) so only part of the relevant digital bitstream will be available to supply ancillary and supplementary services." *Id.* at 15, n.19.

Future developments also appear likely to reduce potential spectrum scarcity values with respect to DTV ancillary and supplementary services. First, more spectrum will become available. The repacked DTV spectrum is a notable example.²¹ Second, the availability of substitutable transmission technologies also is likely to expand.²² Thus, continuing increases in supply of spectrum and substitutable transmission technologies will exert further downward pressure on spectrum values -- and spectrum scarcity rents.

In sum, current trends and future developments provide substantial evidence that spectrum scarcity rents are plummeting with little prospect for a reversal of the trend in the foreseeable future.²³

C. The Social Cost of Excessive Fees Greatly Exceeds the Cost of Overly Modest Fees.

If the Commission is to err, it ought err on the side of lower fees. As Haring observes:

Prudent policymaking generally entails balancing expected losses stemming from different types of decision errors (*i.e.*, mistakes) in such a way as to minimize the adverse consequences flowing from faulty decisions.... In establishing a prudent level of fees, the Commission needs to assess the likely losses that would accrue under different circumstances and set fees in such a way as to minimize any anticipated losses deriving from mistakes that occur in setting fees.²⁴

²¹Haring at 15.

²²Haring at 15.

²³This may tend to explain why several government agencies "have very limited expectations for rents from feeable services." Haring at 8, n.10.

²⁴Haring at 5-6. *See also Memorandum Opinion and Order on Reconsideration of the Sixth Report and Order*, MM Docket No. 87-268, ••• FCC Rcd ••• (1998) Separate Statement of Commissioner Harold Furchtgott-Roth Dissenting in Part ("Finally, as noted above, I am very concerned at the emerging pattern here. We seem to say that as long as there are benefits to a decision, the costs do not matter, and that such decisions are particularly easy if consumers never know what services

In the present case, setting fees too high would lead to considerable losses in consumer welfare. On the other hand, fees set at too low a level would do no more than effectuate a wealth transfer of marginal consequence.

Excessively high fees would create a disincentive to provide services otherwise desired by consumers. Haring states:

If the fees are set too high, there will, generally speaking, likely be adverse consequences primarily in terms of failures to supply services that would be valued by consumers. Ancillary or supplementary services from which consumers would derive benefits (and the government would receive tax receipts) will either not be introduced or will presumably be supplied to a lesser extent than they would were fees set at a lower level. The adverse consequences that flow from the error of setting fee levels too high thus consist largely in losses of consumer welfare on suppressed production of ancillary and supplementary services. Economic welfare gains that would otherwise be enjoyed fail to materialize because the high fees discourage production and innovation.²⁵

The Commission agrees, asserting that:

The means of assessing the fee may affect whether ancillary or supplementary services are offered at all and which services are offered. A fee set too high would serve as a disincentive for broadcasters to provide feeable ancillary or supplementary services. It could reduce the benefits that consumers receive from services provided on the DTV capacity.²⁶

This outcome would clash headlong with the Commission's policy goals. The Commission has acknowledged that:

The 1996 Act evidences the intent of Congress that broadcasters be allowed the flexibility to provide such services. In implementing the statutorily mandated fee program, it is not our intention to dissuade broadcasters from using the DTV capacity to provide feeable ancillary or supplementary services.²⁷

they are missing or how the federal budget is affected. This unwillingness to conduct straightforward cost-benefit analyses and provide consumers all the information they deserve is becoming a shameful hallmark of this agency.”).

²⁵Haring at 6.

²⁶Notice at ¶11.

²⁷Notice at ¶10.

In effectuating this policy the Commission would avoid dashing high hopes that DTV will bring new and diverse services to consumers. In the words of Commissioner Ness:

The flexibility of DTV is vast -- and the full potential is far from fully explored. I know the pictures and sound are wonderful, but I suspect we'll soon be at least equally enchanted by the ancillary and supplemental services that DTV makes possible. Broadcasters will be able to transmit telephone directories, stock market updates, computer software, interactive educational materials -- and the list goes on. Even during the high definition broadcast of a live sporting event, there is sufficient "opportunistic capacity to transmit the entire *Washington Post*, *New York Times*, and *Los Angeles Times* within a matter of minutes.²⁸

Excessive fees also would exacerbate the potential for distorted resource allocation as between feeable and non-feeable services, resulting, again, in losses in consumer welfare. The Commission has recognized this inherent potential for distortion:

The greater the fee, the greater the incentive created by the fee for a broadcaster to use its assigned spectrum to provide free, over-the-air broadcast programming instead of subscription programming or other feeable ancillary or supplementary services. The lower the fee, the more flexible the broadcaster may be in serving audience demand for services and in choosing the mix of services it provides.²⁹

Haring similarly observes:

In principle, as long as the Commission's fees were only to extract the relevant scarcity rents, they would not adversely affect resource allocation and the supply of ancillary and supplementary services. If the fees were to overshoot, they would discourage supply of such services uneconomically. It needs to be recognized, however, that fees for use of spectrum rights only apply to ancillary and supplementary services. Because fees are not to be applied to non-feeable services, the imposition of fees on ancillary and supplementary services may distort resource allocation inefficiently with attendant losses of economic welfare.³⁰

²⁸Remarks of Commissioner Susan Ness, DTV Supersession, Las Vegas, Nevada (January 9, 1998) at 1.

²⁹Notice at ¶26.

³⁰Haring at 4.

In the words of Commissioner Powell, "policymakers must work to avoid ... slowing the pace of innovation in technology and service offerings...."³¹ Setting fees too high, however, would do precisely what the Commissioner fears -- retard development and offering of new services for consumers.

At the same time, high fees would be self-defeating in terms of generating fee revenue for the government. If stations are discouraged from providing feeable services, then less spectrum would be devoted to feeable services and less fee revenues would be generated.³²

If fees were set too low, consequences arise from redistributive effects in favor of DTV licensees and a greater potential for unjust enrichment for stations *vis-a-vis* competing providers of services similar to the ancillary and supplementary services offered by the station. As Haring states, however, "It is easy to say that more is better; it is harder to say that a dollar less for one person and a dollar more for another person represents a *net* loss/gain in economic welfare considered in aggregate."³³ He, therefore, ultimately concludes:

The Commission might avoid "unjust enrichment" by setting very high fees, but only at a tangible cost in terms of sacrifices in economic welfare from the loss of valued ancillary and supplementary services. If the Commission seeks to minimize more harmful losses stemming from suppression of welfare-enhancing production, it should shade its fees lower. The Commission naturally seeks to avoid both types of errors, but the social costs of erring on the high side are likely greater than the social costs of erring on the low side. This argues for taking especial care to avoid setting excessively high fees. In "striking a balance," prudence favors lower fees, other salient factors the same, lest high fees discourage valued production.³⁴

³¹Commissioner Michael K. Powell, "Technology and Regulatory Thinking, Albert Einstein's Warning," Washington, D.C. (March 13, 1998) at 5.

³²See Haring at 6, n.7.

³³Haring at 7, n.8.

³⁴Haring at 7.

Therefore, ALTV posits that the Commission must avoid excessive fees, even at risk of adopting fees initially which ultimately are shown to be too low.³⁵



ALTV agrees with the Commission that a fee based on gross revenues generally would be preferable to fees based on other variables (*i.e.*, incremental profits, net receipts). As the Commission states initially:

In establishing a fee for the feeable ancillary or supplementary use of DTV capacity, we are cognizant of the administrative burden which such a fee could entail. In order to minimize this burden both for broadcasters and for the Commission, the fee should be simple to understand and be calculable with readily available information. An overly complex fee program could be difficult to calculate and enforce and could create uncertainty that might undermine a DTV licensee's business planning.³⁶

With respect to a gross receipts based fee, the Commission concludes:

A fee assessed as a percentage of a licensee's gross revenues from the provision of feeable ancillary or supplementary services would be consistent with the 1996 Act and would avoid some of the infirmities of the fee based upon net revenues described above. Moreover, we believe a fee based upon a percentage of gross revenues could foster our goal of creating a fee structure which does not dissuade broadcasters from offering feeable ancillary and supplementary services. Such a fee would be straightforward to assess and calculate; the licensee would be required to report its gross revenues from feeable ancillary or supplementary services and to calculate a fee based upon a percentage of these revenues. In addition, a fee set at a

³⁵The Commission, of course, retains the authority to adjust fees within the boundaries of the statutory criteria. In that regard, it would do well to remember that higher-than-expected revenues from DTV ancillary and supplementary services in and of themselves provide no indication that fees are too low. Revenues may or may not derive from scarcity rents. (*See Haring* at 14.) Thus, if the Commission adopts a fee regime taking, as it should, cognizance of current auction values, it may be justified in raising fees if auction values increase dramatically (or lowering them if they continue to plummet). However, increases in revenues alone will provide little or no basis for increases in fees.

³⁶*Notice* at ¶9.

percentage of gross revenues provides broadcasters a more certain fee amount to use in their long term planning and decisions.³⁷

Haring, too, states:

A fee based on gross revenues avoids the problem of cost measurement altogether and thus has much to be said for it from the standpoint of economizing on administrative burdens....This approach avoids the problems and administrative burdens associated with cost burdens.³⁸

From ALTV's perspective, a major benefit of ease of calculation is the simplification of enforcement and auditing. Furthermore, sensitive cost and profit information would remain beyond the reach of such processes. This would lessen the deterrent effect of fees on station decisions to provide ancillary and supplementary DTV services. The risk that proprietary information might be exposed to public view would be diminished considerably.

At the same time, a fee based on gross revenues would sidestep complexities in calculation and enforcement inherent in other fee bases. With respect to a net revenue based fee, for example, the Commission has pointed out:

Ascertaining the costs involved in calculation of net revenues may, however, be problematic. Such a determination would necessitate the apportionment of common expenses between and among free television services offered on a licensee's DTV capacity and each feeable ancillary or supplementary use of its DTV capacity. We have concerns as to whether this information will be readily and reliably available.³⁹

Similarly, the Commission questioned the feasibility of a fee based on incremental profits:

This approach has an advantage over the net revenue approach of reduced auditing requirements since joint and common costs do not have to be allocated.

³⁷*Notice* at ¶24 [footnotes omitted].

³⁸Haring at 12.

³⁹*Notice* at 21.

Nevertheless, due to the accounting and enforcement difficulties, especially the potential need to conduct audits, we remain concerned about the feasibility of the incremental profits fee.⁴⁰

Therefore, fees based on gross revenues would provide a relatively simple and easy to administer fee regime.

THE CRITICAL VARIABLE IN ANY FEE STRUCTURE IS THE AMOUNT

The critical variable in any fee structure is the amount. In the case of a fee based on gross revenues, the percentage rate of the fee is the ultimate focal point of the analysis. As the Commission states:

If the fee is assessed as a percentage of revenues or incremental profits, the percentage rate of the fee, more than the process by which it is derived will determine the degree to which the fee affects broadcasters' decisions.⁴¹

The Commission then sets out an initial range from "one percent or less of gross revenues generated from feeable ancillary and supplementary services ... up to a more substantial ten percent of gross revenues."⁴²

Strong considerations favor a fee at the lower end of the range (*i.e.*, no more than one per cent). First, a fee based on gross revenues takes no account of costs.⁴³ As Haring asserts:

A fee based on gross revenues....requires a compensating adjustment in the level of applicable percentage fee rates to reflect the existence and non-inclusion of relevant costs and the resultant overstatement of profits and rents....At the same time, unless

⁴⁰Notice at ¶¶22-23.

⁴¹Notice at ¶26.

⁴²Notice at ¶27.

⁴³Notice at ¶13.

care is taken to adjust the applicable percentage fee rate to reflect the non-measurement of costs, it runs the risk of mis-gauging the actual extent of scarcity rents, establishing excessive fees and imposing economic welfare costs in terms of an under-supply of ancillary and supplementary services.⁴⁴

Second, as Haring posits, "There is...considerable evidence suggesting that scarcity rents are not likely to amount to much."⁴⁵ Therefore, a fee at the low end of the range is likely to recover anticipated spectrum scarcity rents.⁴⁶

Finally, despite the uncertainty inherent in the entire fee-setting exercise, Haring concludes:

In this kind of situation, it often makes sense not to try to cross bridges until you come to them. The problem is that there may not be any bridges to cross if mistakes are made early on which deter investments and creation of new markets. As noted earlier (at pages 5-7, *supra*), that supplies a principled argument for taking care not to kill golden-egg producing ventures before they are hatched by setting fees at excessive levels.⁴⁷

⁴⁴Haring at 12.

⁴⁵Haring at 14.

⁴⁶See Haring at 15-16 ("Suppose the scarcity value of the DTV ancillary and supplementary rights were put at about \$40 million, *i.e.*, *equivalent* (on a per-pop per-MHz basis) to what the LMDS rights recently fetched at auction. This is still a generous estimate given the "ancillary and supplementary" nature of the services whose provision is authorized through partial/constrained use of the DTV bitstream. Assuming a 10-percent discount rate and 15-year term for purposes of simple estimation, a \$40 million capital valuation amounts to a little more than \$5 million on an annual basis. If the annual sales volume of ancillary and supplementary services amounted to about \$500 million per year, an amount that does not appear implausible on its face, a 1-percent percentage fee rate would thus generate the annualized capital value.").

⁴⁷Haring at 14. He also notes that, "The scarcity value of these particular spectrum operating rights is uncertain. How can it be otherwise when business plans for exploitation of the rights are only now in the course of being formulated.")

Therefore, a fee at the low end of the Commission's specified range -- one per cent or less of gross revenues -- is likely to be reasonable.⁴⁸

V. FEES SHOULD BE BASED ON REVENUES FOR UNIFORMITY AND SURETY

The imposition of fees in the form of a percentage of gross revenues, despite its practical benefits, would be inappropriate and counterproductive in one circumstance -- where a station derives no profit from a ancillary or supplementary DTV service. In such a situation, the Commission should waive fees upon a proper showing by the DTV licensee.

Such waivers would recognize that no scarcity rents exist. Haring points out that:

The Commission then turns to explicit consideration of three regimes in which fees are assessed on the basis of licensees' net revenues, incremental profits and gross revenues respectively. A seeming advantage of the first two approaches is that they tie fee payments to the actual realization of economic surplus/rent. Not all (or indeed any) rents may be attributable to spectrum scarcity, but if there are no rents, that precludes there being any spectrum scarcity rents.⁴⁹

⁴⁸A desirable adjunct to a low gross receipts fee, in light of the statutory requirement that fees not exceed those derived from competitive bidding for the spectrum, would be a cap on the total fees collected from a DTV licensee over the term of its license. As Haring (at 9) observes:

It is hard to see how the tie can be cut completely given the statutory language previously recited. The Commission's seeming desire to cut the tie is itself a little discomfiting since the capital value or hypothetical auction value of the scarcity rents places a theoretical limit or "cap" on the fee revenues the government can legitimately and legally collect. Cutting the tie to the hypothetical auction value thus removes a protection against and may, thereby, invite an over-recovery of scarcity values by the government which could, in turn, thwart provision of feeable services.

Therefore, to remain consistent with the statute, the Commission ought cap fees assessed as a percentage of gross revenues.

⁴⁹Haring at 11.

They also would afford DTV licensees the breathing room "to build their feeable ancillary or supplementary services to the break-even point without the assessment of a fee, fostering the development of these new services."⁵⁰ Consequently, Haring recommends:

In addition to ensuring that the applicable percentage fee rate is suitably discounted, we think it would perhaps also make sense, if the gross revenue approach were adopted, for the Commission to adopt a safeguard affording licensees the right to file relevant cost data demonstrating the absence of profits and rents and consequent absence of liability for spectrum fees, should they wish to do so. If the Commission has made appropriate compensation for non-inclusion of costs in gauging fee liabilities, incentives to seek such waivers will likely be minimal. By the same token, should waivers be frequently sought, that would signal the Commission that it has likely erred and failed to set an adequately discounted percentage fee rate.⁵¹

Therefore, stations which are willing to undertake the burdens and risks of demonstrating the lack of profitability of their ancillary and supplementary services should be granted fee waivers for any of their services which operate unprofitably.⁵²

⁵⁰*Notice* at ¶21. As Commissioner Powell recently stated, "Additionally, we must remember that there must be incentives for firms to invest in R&D, which often does not pay off for some time." Powell (March 13, 1998), *supra*, at 6.

⁵¹Haring at 12.

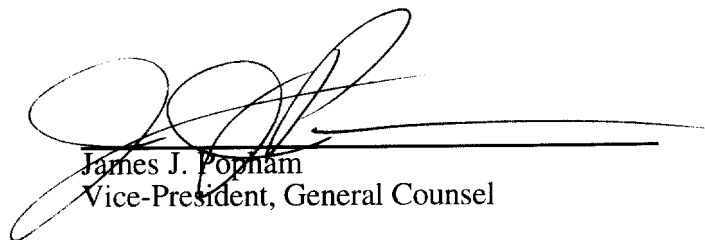
⁵²By and large, this would be most likely to encompass services in their start-up phase. Ultimately, they would either reach profitability or fail. In the former case, the waiver would terminate and fees would be collected. In the latter, no fees would be lost because the service would discontinued.

VI. CONCLUSION

In view of the above, ALTV urges the Commission to adopt a fee regime with the following central features:

- A fee based on a modest percentage (one percent or less) of gross receipts.
- Fee waivers for unprofitable services.
- A cap on fees so as to avoid recovering fees in excess of the spectrum scarcity values.

Respectfully submitted,



James J. Popnam
Vice-President, General Counsel

**Association of Local Television
Stations, Inc.**
1320 19th Street, N.W.
Suite 300
Washington, D.C. 20036
(202) 887-1970

May 4, 1998

**STRATEGIC
POLICY
RESEARCH**

7500 OLD GEORGETOWN ROAD SUITE 810 BETHESDA, MARYLAND 20814 (301) 718-0111 (301) 215-4033 fax
EMAIL spri-info@spri.com

**Fees for Ancillary and Supplementary Use of
Digital Television Spectrum**

John Haring*

**Prepared for
Association of Local Television Stations**

April 28, 1998

* John Haring is a principal in Strategic Policy Research, Inc., an economics and telecommunications policy consulting firm located in Bethesda, Maryland. Dr. Haring formerly served as Chief Economist and Chief, Office of Plans and Policy, at the Federal Communications Commission.

Introduction

In this proceeding the Commission seeks to implement the Telecommunications Act of 1996's requirement that a fee be assessed for ancillary or supplementary use of the spectrum when a licensee receives either subscription fees or compensation for transmitting material furnished by a third party. In its *Notice of Proposed Rule Making* (NPRM),¹ the Commission has identified a variety of alternative programs by which such fees might conceivably be assessed consistent with statutory requirements and objectives. It seeks comment on a number of general and specific economic issues that are posed in weighing the comparative abilities and disabilities of various alternatives under consideration. In this submission we offer an economic commentary on the Commission's proposals and seek to address the principal questions the Commission has raised in a constructive way.

To anticipate our major conclusions, we generally share the Commission's tentative conclusion that a simple fee assessed as a percentage of gross revenue likely constitutes a workable approach to meet statutory requirements and objectives in a practical way. This conclusion presumes that the applicable percentage fee rate is established at an economically reasonable level and that licensees are afforded the right to seek fee waivers consequent upon a showing that spectrum scarcity rents are not being earned. In addition to explaining the economic reasons why we have come to this conclusion, we also describe the analytical and empirical basis for our conclusion that the economically optimal fee should be established as a *small* percentage of gross revenue derived from so-called "feeable" services.

Asymmetries in the loss function associated with mis-specification of fee levels supply a strong analytical basis, grounded in welfare economics, for taking pains to avoid excessive fees. In addition, since fees are only to apply to ancillary and supplementary services, the imposition of fees will alter economic incentives at the margin to supply such services in place of non-feeable services. High fees may thus deter economically efficient substitution of feeable for non-feeable services. There are also compelling empirical grounds to think that spectrum scarcity values are likely to be

¹ FCC, *In the Matter of Fees for Ancillary or Supplementary Use of Digital Television Spectrum Pursuant to Section 336(e)(1) of the Telecommunications Act of 1996*, MM Docket No. 97-247, December 19, 1997.